

July 29, 2003

Debra Davenport, CPA
Auditor General
Office of the Auditor General
2910 N. 44th Street, Suite 410
Phoenix, AZ 85018

Dear Ms. Davenport:

Arizona Correctional Industries (ACI) appreciates the insights shared in the Management Letter from your certified audit performed on our division for the year ending June 30, 2002. Attached is our response to your audit findings and related recommendations.

If you have any questions, please contact me at 272-7600 or Dale Beatty the ACI controller.

Sincerely,

John J. Spearman
Assistant Director

JJS:cs

Attachment

**ARIZONA CORRECTIONAL INDUSTRIES
AUDITOR GENERAL RESPONSE
FOR THE YEAR ENDED JUNE 30, 2002**

RECOMMENDATION 1: ACI should ensure inventories and cost of goods sold are properly valued.

We concur. A critical component in establishing costs of goods sold are inventory balances. In reviewing the FY 2002 inventory valuation it is important to note that no less than 73% of the inventory balance is raw material which had not entered into the production process and is based on standard costs updated frequently. To our knowledge the auditor general is satisfied with this process. Regarding the valuation of finished goods, it is important to note that these amounts are comprised of material, labor, and overhead. The majority of the products are in the two sewing divisions and bedding. These are generally standard products that sell for less than \$10 each.

All standard product costs of manufacture are reviewed semi-annually and more often if necessary and adjusted as required. All non standard products have a developed cost of manufacture before they are produced. For most of the divisions, labor and overhead are allocated to inventory based on a standard shop rate. This rate is tested against the actual financials on a quarterly basis and adjusted as necessary. ACI believes in aggregate the inventories are substantially accurate and will continue to practice procedures that clearly support the expressed inventory balances.

RECOMMENDATION 2: ACI should reconcile the subsidiary ledgers to the general ledger.

We concur. An integral discipline associated with the preparation of accurate financial statements includes the reconciliation of the general ledger to its subsidiary ledgers. Our policy requires the reconciliation of both monthly and year-end ACI financial statements. The largest of the errors resulting in this recommendation occurred when ACI's computer system failed while amounts were being posted to their respective accounts thus causing an out-of-balance subsidiary ledger. An inadequate attempt by staff to correct the balance resulted in our accounts receivables being out of balance by \$23,000 at year-end. This failure has been corrected without impacting the statement of operations. ACI will more closely adhere to its policy to ensure accurate reconciliation is completed on a monthly basis.

COMMENDATION 3: ACI should improve its recordkeeping procedures over its assets.

We concur. The Construction-In-Progress (CIP) account is intended to capture costs related to large projects. These costs are accumulated, analyzed, and distributed to their proper accounts at the completion of the project. Most of the costs are capitalized into their respective fixed asset accounts. For Fiscal Year 2002, some costs associated with ACI's move to its new building were accumulated in the CIP account and were not subsequently moved to the appropriate fixed asset account. As a result, the costs were incorrectly left in the CIP account. Approximately \$40,000, of these costs, should have been expensed. Appropriate adjustments correcting the accounts were made in accordance with instructions from staff of the Auditor General's Office. It should be noted that depreciation for the assets was properly recorded in FY 2002.